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Buyers Should Understand Yield Spread Premiums

Going through a mortgage broker is a very popular way to obtain a home loan these days. In fact, some industry insiders estimate that as much as 70 percent of all home loans are originated by mortgage brokers. This is probably the result of the unique function that brokers play in the market. Individual banks and mortgage lenders each offer a specific set of loan programs and terms. Brokers act as the middlemen for home buyers and lenders. Brokers work with dozens of different lenders, allowing them to offer buyers a wider range of loans and helping them bypass much of the tedious shopping for the best mortgage rate.

Unfortunately, as with every industry, there are some brokers willing to take advantage of consumer ignorance. With brokers, this often happens in connection with the yield spread premium (YSP). The YSP is the difference between the lowest rate a borrower qualifies for and a higher rate the borrower actually gets charged by the lender. For example, a broker finds a home loan for a borrower with a 6.0 percent interest rate, but both the lender and the broker would like to make more than that. So, without telling the borrower that he actually qualified for a 6.0 percent interest rate, the broker offers the borrower the same loan with a 6.25 percent interest rate. The broker then gets paid a percentage of that quarter point yield spread by the lender. You can see how unscrupulous brokers would be tempted to increase the YSP in order to increase their own profits.

Another way brokers may increase the YSP is by offering loans with “no closing costs.” The borrower saves thousands of dollars upfront, but the cost of the fees is added into the total cost of the loan, raising the YSP and interest charges.

This deal may not be as bad as it sounds for borrowers though. If they do not plan to stay in their home for many years, avoiding the upfront fees may be worth the higher interest rate to them.

A problem arises however, when the extra fees and higher rates are exorbitant. And that is where consumer awareness becomes so important. While it is the job of brokers to find borrowers the best deal from all their various connections, the truth is that they are also looking for their own profit – that is the nature of business. Because of this fact, it is important for home buyers to educate themselves about loan programs and the going rates of the day. Borrowers can first find out their credit score and then search online to find out what type of interest rate others with their credit score range are receiving. MyFICO.com is a great website that shows home buyers the average interest rate being offered to people in their credit range by state. Knowing this information will help borrowers to know if the rate their broker is offering is truly fair.

Borrowers should also take shopping around for a mortgage into their own hands. They should get quotes from at least two or three different brokers or lenders to compare the interest rates offered. That way they will have leverage at the bargaining table, as the broker will know that other companies are competing for the borrower’s business.

Above all, vigilance on the part of the home buyer will protect them from being taken advantage of by mortgage brokers.